CANADA'S FISCAL IMBALANCE

RESOLVING THIS ISSUE IS KEY TO SUSTAINING HEALTH CARE AND OTHER SOCIAL PROGRAMS

APRIL 25, 2002

A PERSPECTIVE FROM CANADA'S PROVINCIAL AND TERRITORIAL MINISTERS OF FINANCE

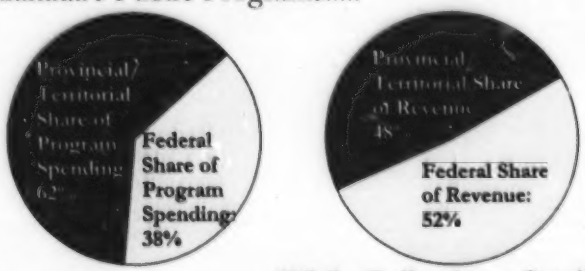
Why should Canadians care about this issue?

- **Canadians expect quality health care and other public services to be provided throughout the country. This expectation can not be met if the fiscal imbalance issue is not addressed.**
- **Provinces are having to respond to fiscal pressures from the health care sector with inadequate fiscal resources. This has necessitated tax increases, deficit financing, and deep program cuts in other areas.**
- **In contrast, the federal government is likely to run a large and growing surplus in coming years. In part, this is a consequence of the federal government's failure to fulfill its obligation to adequately fund health care and other social programs through fiscal arrangements with the provinces and territories.**
- **Successfully resolving the fiscal imbalance problem would enable health care to be adequately funded without tax increases or deficit financing.**

What is fiscal imbalance?

- Fiscal imbalance describes the situation where one or more governments do not have the ability to raise sufficient revenues to fund their programming responsibilities, while other governments have more revenue than required to finance their areas of jurisdiction.
- Figure 1 shows the inherent fiscal imbalance in Canada: the federal government has revenue-raising abilities

Provinces and Territories Provide the Lion's Share of Canada's Public Programs.....


Provincial/ Territorial Share of Program Spending: 62%
Federal Share of Program Spending: 38%
Provincial/ Territorial Share of Revenue: 48%
Federal Share of Revenue: 52%

.....While Collecting a Smaller Share of Revenue than the Federal Government

Data reflect 2001/02. Spending data excludes transfers. Revenue data refers to "own source" revenue. Source: Public Accounts.

Figure 1

which considerably exceed the cost of fulfilling federal program responsibilities, while the provincial and territorial governments lack the revenue-raising capacity to meet their constitutional spending responsibilities, especially in the areas of health care, education and social services.

- Provinces and territories provide 62 percent of all program spending in Canada and this share is increasing. These governments are constitutionally responsible for delivering what most Canadians view as their key social programs: health care and education. These are the fastest growing programs of the provinces and territories, receiving about two thirds of their program spending.
- Only 38 percent of all public services is provided through federal channels and this proportion is projected to decline.

What Has Been the Main Approach to the Fiscal Imbalance Situation?

- Federal funds provided directly to provinces, known as federal transfers, supplement the "own source" revenues provinces and territories collect themselves and, in so doing, partially offset the negative effects of fiscal imbalance.
  - The Canada Health and Social Transfer (CHST) provides funding specifically targeted towards essential health, education and social assistance programs, many of which support broad, Canada-wide objectives.
  - Equalization funding is intended to ensure that all provinces are able to provide comparable levels of programs and services at comparable levels of taxation.
- It should be stressed that to accomplish their crucial programming goals, provinces and territories must have access to adequate funding, from both their own-source revenues and federal government transfers.
- Figure 2 illustrates that this adequacy has not been achieved with respect to federal transfers. Over two decades, there has been a significant erosion of federal support in meeting costly provincial and territorial social programming needs.
- This erosion, which reflects a series of specific policy decisions made by the federal government over the years, has undermined the ability of provinces and territories to deliver services at a level of quality Canadians expect.

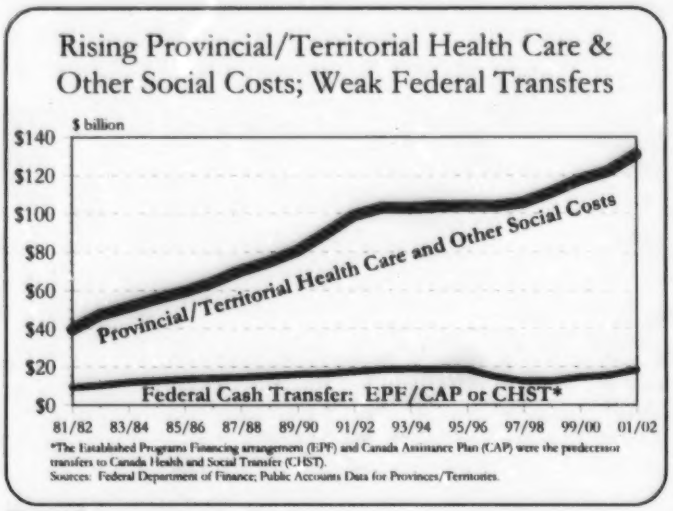

Rising Provincial/Territorial Health Care & Other Social Costs; Weak Federal Transfers
$ billion
$140
$120
$100
$80
$60
$40
$20
$0
Provincial/Territorial Health Care and Other Social Costs
Federal Cash Transfer: EPF/CAP or CHST*
81/82 83/84 85/86 87/88 89/90 91/92 93/94 95/96 97/98 99/00 01/02
*The Established Programs Financing arrangement (EPF) and Canada Assistance Plan (CAP) were the predecessor transfers to Canada Health and Social Transfer (CHST).
Sources: Federal Department of Finance; Public Accounts Data for Provinces/Territories.

Figure 2

Aren't all governments facing spending pressures?

- Both the federal and provincial/territorial orders of government are facing spending pressures but these differ considerably in magnitude and intensity. As Figure 3 shows, provincial and territorial program costs are growing considerably more quickly than federal program costs.

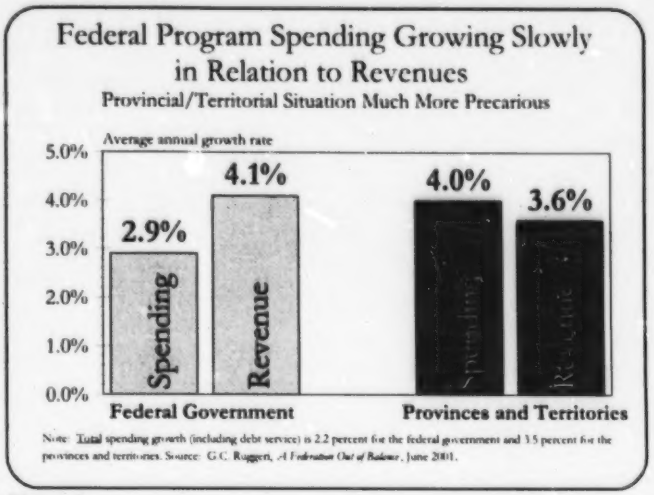


Figure 3

- This difference becomes acute in the context of significantly slower growth of provincial and territorial revenues relative to federal revenues.

Can't the provinces and territories simply raise their tax rates to obtain the funding they need for their programs?

- In today's world, provincial and territorial governments are greatly constrained in their tax flexibility. Economic development goals impel them to ensure that their tax burdens are comparable, particularly for major revenue sources such as personal and corporate income tax.
- The federal government has strongly upheld its own use of tax cuts as an economic stimulus and has applauded provincial and territorial efforts in this direction.
- The suggestion that provinces and territories raise taxes - to make up for federal funding shortfalls for provincial social program costs - is inconsistent with the desire of Canadians for quality social programs and reasonable taxation levels, particularly at a time when the federal government enjoys fiscal surpluses.
- Sufficient taxes are already being levied by the federal government to address the fiscal imbalance, including adequately funding health care.

Which order of government has the highest future fiscal potential?

- It is notable that even with the tax cuts and new spending initiatives announced by the federal government in the past few years, the federal surplus is likely to grow considerably over the next two decades (Figure 4, overleaf).
- This ongoing series of surpluses should enable an appropriate restoration of federal funding support for health care and other social programming.
- It should also enable significant payments toward reducing the federal debt.

- As well, it should be noted that the federal government has practised very conservative budget forecasting over the past several years. For any given year, the final federal fiscal position has been much stronger than that forecast in the budget.

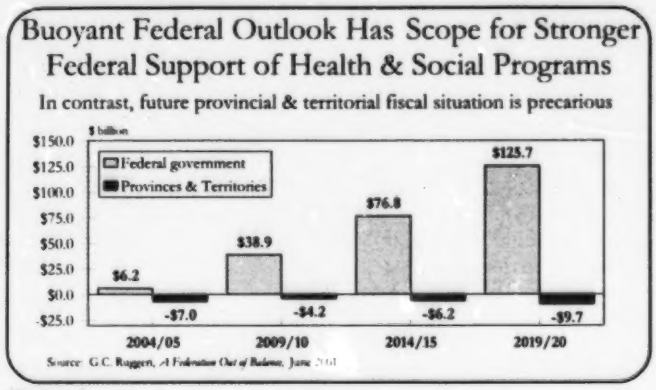


Figure 4

Shouldn't high levels of federal debt be taken into account?

- Federal debt is indeed higher than total provincial and territorial debt. But, as noted above, federal budget surpluses generated by the current imbalance provide the resources to pay down federal debt as well as increase transfers to provinces.
- In contrast, the negative effect of fiscal imbalance hinders provincial and territorial ability to reduce debt levels.
- Further, it is an often overlooked fact that a number of provinces are currently approaching federal levels of debt (measured against the size of their economies).

How does fiscal imbalance distort national priorities?

- The current situation of imbalance has enabled the federal government to use its "spending power" to engage in many new activities. It should be understood that these initiatives are being offered at the expense of adequate federal support of the health care system and other key social programming.

How can the fiscal imbalance be corrected and adequate funding guaranteed for health care?

- For the past few years, Premiers have vigorously urged the federal government to fund a fairer and more appropriate share of health care and other major social programming costs. As Figure 5 shows, the federal share currently stands at 14 percent and will decline without remedial action.

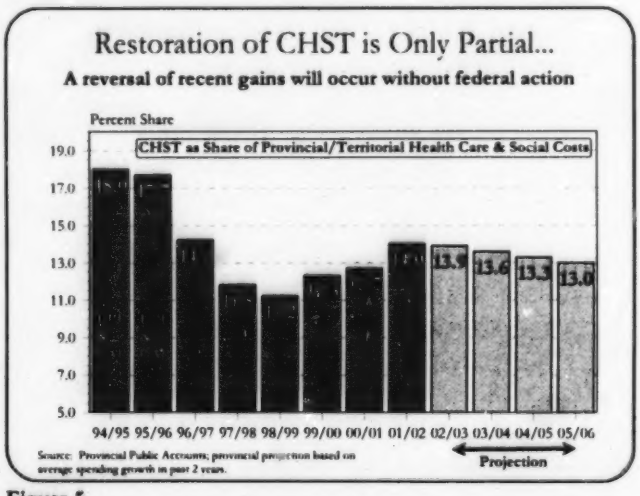


Figure 5

- Further, Finance Ministers reaffirm their commitment to a strengthened Equalization program and call on the federal government to act on this immediately.
- The Senate Standing Committee on National Finances in its recent report recognizes that Equalization has become an essential element in federal-provincial fiscal relations and requires strengthening.
- Premiers have called for:
  - immediate removal of the Equalization ceiling;
  - immediate work on the development of a strengthened and fairer Equalization program formula, including as one possible alternative, a ten-province standard that recognizes the volatility around resource revenues, and comprehensive revenue coverage.
  - restoration of federal funding through the CHST to cover at least 18 percent of program costs and the introduction of an appropriate escalator to maintain the CHST's value in coming years; and,
  - work on other CHST measures, including tax-point transfers as one possible alternative to the current CHST transfer.

Honourable Gary Collins
Minister of Finance - British Columbia

Honourable Pat Nelson
Minister of Finance - Alberta

Honourable Eric Cline
Minister of Finance - Saskatchewan

Honourable Gregory Selinger
Minister of Finance - Manitoba

Honourable Janet Ecker
Minister of Finance - Ontario

Honourable Pauline Marois
Ministre des Finances - Québec

Honourable Neil LeBlanc
Minister of Finance - Nova Scotia

Honourable Peter Mesheau
Minister of Finance - New Brunswick

Honourable Patricia J. Mella
Provincial Treasurer - Prince Edward Island

Honourable Joan Marie Aylward
Minister of Finance - Newfoundland and Labrador

Honourable Pat Duncan
Minister of Finance - Yukon

Honourable Joe Handley
Minister of Finance - Northwest Territories

Honourable Kelvin Ng
Minister of Finance - Nunavut

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